No. 42

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

CAPITAL GAINS RESEARCH BUREAU, INC. AND HARRY P. SCHWARZMANN,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENTS.

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Opinions Below.

The Circuit Court *en banc* held:

"* * * There is no proof that defendants employed 'any device, scheme or artifice to defraud any client or prospective client' or engaged 'in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. * * * (306 F. 2d 606, 609.) (R. 65.)

* * * * * *

"No proof having been presented under sections 206(1) and (2) sufficient to justify the granting of a preliminary injunction, the order appealed from is affirmed." (p. 611.) (R. 70.)

The District Court found there was no fraud or deceit and none was intended.

"* * * There is no proof here that any client * * * lost a single dollar * * * or that defendants intended that any client * * * should * * *.

* * * * * *

"* * * there is nothing to indicate that defendants intended anything but maximum profits for their clients * * *." (191 F. Supp. 897, 899.) (R. 21.)

Statute Involved.

Preliminary injunction was sought for alleged violation of the Investment Advisers Act of 1940, Section 206, Subdivisions (1) and (2)[1] (54 Stat. 852, 15 USC 80b-6).

"§ 80b-6. Prohibited transactions by investment advisers

"It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

"(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

"(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the

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[1] The Statute was amended September 6, 1960 by adding Subdivision (4) which was in effect at the time of the application for the preliminary injunction.

Penal sanctions are provided for violation (§80b-17).

capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

"(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."

Question Presented.[2]

Whether a preliminary injunction was properly denied for failure of proof of a "device, scheme or artifice to defraud" or a "practice * * * which operates as a fraud or deceit" upon an investment adviser's clients in violation of Section 206(1) and (2) of the Investment Advisers Act of 1940, where the honesty of the advice is unquestioned, the recommendations made in good faith, the subscribers in the instances complained of in fact had the opportunity to profit 34 to 84%, three decisions below found no proof of fraud or deceit or intent, and where the adviser, after research and deciding to recommend a stock, in some instances bought a small number of shares but did not retain them for long-term gain and did not include in his

[2] The SEC states the question presented is "scalping". This term does not appear in the moving papers and is adopted by the minority without proof. It does not appear in any law, rule, or regulation of the SEC. The term has no sinister connotation. It existed before the SEC or investment advisers. It merely describes quick trading for fractions or a point by floor traders who do not have to pay commissions and therefore can so trade. *Munn's Encyclopédia of Banking and Finance*, p. 667.

bulletin a so-called broker-dealer "disclosure clause" that he "may from time to time hold securities recommended", not knowing of any rule requiring disclosure.

Statement.

Harry P. Schwarzmann, or his company, has been a registered investment adviser since 1953. He is a man of good repute and sound business background. He left the presidency of a substantial corporation, with a salary of $72,500 a year, to organize his own business (R. 24, 26).

Capital Gains issued two publications. One, "Facts on the Funds", contained solely statistical information of portfolio changes of the leading mutual funds. It was distributed periodically to about twenty thousand subscribers for a fee of $24 per year (R. 26).

The other publication, here involved, a "Special Bulletin" or "A Capital Gains Report", was subscribed to by about five thousand at $18 per annum (R. 26, 27). This publication was issued after research of a particular stock, and management consultation, giving statistical and analytical data, and generally contained a recommendation of a stock to be purchased for long-term appreciation (R. 22, 27).

The implication of the SEC (adopted by the minority below), that bulletins were issued sometimes to one hundred thousand non-subscribers to create buying, is absolutely false (R. 27). Reason and arithmetic confirm the fallacy of the premise. The cost of issuing 100,000 bulletins (postage, printing, mailing of $7,000-$8,000) would have caused respondents a substantial loss on all but one transaction and a very considerable total loss on the combined total.

This suit was started precipitously in November, 1960, after a two-day investigation (R. 23, 24). Prior to the suit

the SEC was informed that, while Capital Gains believed it had a right to make use of its own research to trade in the open market—and had not committed any fraud or deceit—it was, nevertheless, willing to abide by any rule or regulation as to trading or make any disclosure of transactions which the SEC suggested (R. 22-24, 26). The practice complained of ceased immediately without necessity of suit, but, regardless, the SEC embarked upon this litigation now three years old.

Preliminary injunction was sought on an affidavit "on information and belief" (R. 9). Mr. Schwarzmann's answering affidavit was not replied to and stands unchallenged.

It is not disputed that the recommendations to subscribers were sound; that, in seven years as an investment adviser, Mr. Schwarzmann had never written on a questionable stock; that each recommendation was carefully selected, thoroughly researched and investigated (R. 22). All of the stocks are nationally known and listed on the New York Stock Exchange, save one on the American Stock Exchange. The reports were an unbiased and careful selection made in good faith to provide subscribers an opportunity for long-term capital appreciation (R. 22). Subscribers had, in each instance complained of, the opportunity for substantial profit, as shown in the following chart.

Name of Stock	Price When Recommended	Subsequent High	% Increase	% Profit Realized by Capital Gains on its Transactions
Continental Insurance	\$48½	\$74⅞	54.4	2.0
United Fruit	22¾	30½	34.1	8.8
Creole Petroleum	25⅝	42¾	66.8	1.0
Hart, Schaffner & Marx	23	36½	58.7	6.0
Frank G. Shattuck	17	31⅜	84.5	6.8
Union Pacific	25	37⅛	48.5	3.2

Capital Gains' purchases were made after research and after it had determined to recommend a stock for long-term appreciation.

There was nothing secret about the transactions. Stocks were openly bought and sold in the name of Capital Gains through member firms of the Exchange (R. 23). There was no proof that any subscriber did in fact purchase any stock referred to in the bulletins.

The number of shares purchased by Capital Gains was insignificant compared to the outstanding stock of the companies involved:

	Shares Purchased	Outstanding Shares
Continental Insurance	500	11,998,000
Creole Petroleum	2,000	77,621,000
Union Pacific	2,000	22,439,000
Hart, Schaffner & Marx	600	875,695
United Fruit	5,300	8,733,000
Shattuck	600	1,104,000

In two instances (Continental Insurance and Shattuck) stock was purchased after issuing the reports, as well as before (R. 28, 29).

There was no proof that the transactions of Capital Gains in any way interfered with the profit that might have been made by any subscriber who followed the recommendation.

There was no proof that Capital Gains' recommendations influenced the market; there are hundreds of investment advisers and thousands of brokers who recommend stocks. We know in one instance (Union Pacific) purchase of the stock had been recommended by Standard & Poor's, the largest nation-wide advisory service, ten days before Capital Gains' recommendations (R. 30). Three leading New York Stock Exchange houses recommended Continental Insurance after Capital Gains (R. 30).

The SEC chart (SEC brief, p. 6) is incorrect in four out of seven transactions and overstates the total profit of Capital Gains by over 90%. Their statement that their data is unchallenged is contrary to fact. It was and is challenged by Mr. Schwarzmann's answering affidavit which was never contradicted.

The correct figures are: The profit on Continental Insurance was $89 instead of $1,125 (R. 29); on Creole, $569 instead of $1,762 (R. 31); on Union Pacific, $1,599 instead of $1,757 (R. 31), and on Chock Full O'Nuts, a loss of over $4,000 instead of a profit of $2,772.33 (R. 29).[3]

Chock Full O'Nuts.

This transaction is charged as part of a scheme to defraud subscribers. Capital Gains never recommended the stock for purchase and had no knowledge whether any subscriber owned a single share (R. 28). It did not recommend a sale or short sale. The bulletin in question was a study of the relative values of Chock Full O'Nuts and Shattuck (Schrafft's), pointing out that at current prices there was far greater opportunity for profit in Shattuck and recommending it for purchase (R. 28, 29, 42, 43).

Mr. Schwarzmann's views were confirmed by no less an authority than William Black, President of Chock Full O'Nuts, who wrote Mr. Schwarzmann on October 19, 1960:

[3] Among the causes of error, the SEC has failed to deduct brokerage commissions and charges, which, on the 500 shares of Continental Insurance they refer to, amounted to $465.18. In addition, they exclude the purchase of 500 shares of Continental Insurance four days after the bulletin, which they "deem inapplicable to the question in this case". It is as important as any other fact in determining intent to defraud or deceive. They further fail to account for a loss of $6,962.50 in Chock Full on options which were worthless at the time of Mr. Schwarzmann's affidavit (R. 28, 29), and at the expiration date of the options, which the SEC well knows as it is public information.

"Dear Mr. Schwarzmann:

"I read your analysis of our stock as compared with Schrafft's.

"I agree with you. Our stock is overpriced. Schrafft's is underpriced. * * *"

This letter was not made public at the hearing as the respondents feared that publicity thereof might cause a debacle in the stock and serious loss to thousands of stockholders. It was, however, presented to the SEC's attorney in the District Court on the hearing of the motion.

Capital Gains' transactions in Chock Full O'Nuts were Mr. Schwarzmann's private affair and had no relation to subscribers. It had completed transactions in the stock in July and September, 1960, long before there was any thought of writing the bulletin of October 14th (R. 28).

Summary of Argument.

A preliminary injunction was properly denied in November, 1960, for failure of proof of a "device, scheme or artifice to defraud" or a "practice * * * which operates as a fraud or deceit" upon an investment adviser's clients in violation of Section 206(1) and (2) of the Investment Advisers Act of 1940.

The decision below is not predicated upon a narrow construction of the statute, but on failure of proof. The statute having penal sanctions may not be extended beyond its terms. Three decisions have found no proof of fraud or deceit or intent and these findings, supported by the record, are unassailable under the rule of this Court.

The respondents' recommendations were for long-term gain, which, in the instances complained of, the subscribers had from 34 to 84%. The SEC contends, contrary to the

decided cases, that, regardless of honest advice and intent, because Capital Gains, after research and deciding to recommend a stock, purchased a small number of shares before issuing a bulletin and did not hold the stock for long-term gain as recommended without the bulletin containing a so-called "broker-dealer disclosure footnote" that "we may from time to time hold stocks recommended", it is a breach of fiduciary duty and fraud and deceit.

Breach of fiduciary duty is not a violation of the statute —fraud and deceit are required. The duty owed by Capital Gains was to make honest recommendations with honest intent that subscribers would have opportunity for long-term gain, which they had 100%.

The SEC has conceded that if Capital Gains had purchased and held for a long-term gain there would be no necessity of disclosure and no fraud because they were doing exactly as recommended. It cannot become fraudulent if they held for five months and 29 days instead of six months, or for any lesser period.

To constitute a fraud or deceit the non-disclosure must not only be of a material fact but with intent to deceive or defraud. The respondents' transactions were not a material fact as to whether the advice was honest or given with the intent that subscribers have the opportunity for long-term gain.

The insertion in the bulletin of the so-called "broker-dealer disclosure clause" would give subscribers no more information as to whether the recommendation for long-term profit was sound and given with honest intent than if omitted.

In the decided cases involving broker-dealers, where non-disclosure has been held material and deceitful, there was a wrongful motive and intent to deceive by non-disclosure.

On petitioner's theory it would be fraudulent for an adviser not to buy every stock recommended unless he tells subscribers that he does not follow his own advice.

The respondents' recommendations did not become "disinterested" by buying shares where their decision to recommend preceded the purchases, and the advice was honest and for the purpose of enabling subscribers to obtain long-term gain.

An investment adviser has the right to use his own work product to buy and sell in the open market, barring some regulation to the contrary.

No rule has ever been promulgated by the SEC, although it had general rule-making power since 1940 and obtained an amendment to the statute in 1960 to deal with "problems as a *material* adverse interest". (Emphasis supplied.)

There was no necessity for this suit or injunctive relief. The respondents ceased purchasing securities that were to be recommended when the SEC indicated disapproval prior to the commencement of the suit. The situation should have been treated as an administrative problem as the Commission has the power to suspend or revoke licenses. There was no abuse of discretion in denying a preliminary injunction.

The SEC has violated the law by publicizing this to be "the biggest fraud of its kind" before respondent had the opportunity to file an answering affidavit, ruining his reputation and business, and prejudicing his rights to a fair trial on the merits.

ARGUMENT.

The Decision Is Not Predicated on a Narrow Construction of the Statute but on Failure of Proof.

The decision below is not based upon a narrow construction of the statute but solely upon a failure of proof of fraud or deceit. The Court held nothing more.

The statute, having criminal sanctions (80b-17) making a violation a felony, may not be extended beyond its terms. *United States* v. *Resnick,* 299 US 207, 210 (1936); *cf. Barber* v. *Gonzales,* 347 US 637, 642 (1954); *Blau* v. *Lehman,* 368 US 403 (1962).

This rule is applicable in civil cases involving a penal statute. There cannot be one construction for the SEC and another for the Department of Justice.

In *Federal Communications Commission* v. *American Broadcasting Co., Inc.,* 347 US 284, 296 (1954), a civil case for an injunction, this Court held:

> "It is true, as contended by the Commission, that these are not criminal cases, but it is a criminal statute that we must interpret. There cannot be one construction for the Federal Communications Commission and another for the Department of Justice. If we should give §1304 the broad construction urged by the Commission, the same construction would likewise apply in criminal cases. We do not believe this construction can be sustained. Not only does it lack support in the decided cases, judicial and administrative, but also it would do violence to the well-established principle that penal statutes are to be construed strictly."

The elements of fraud and deceit are well established.[4]

Fraud is never to be presumed and must be established by clear, convincing, and satisfactory proof.[5]

Intent to defraud or deceive is a necessary ingredient of a violation of the statute. *Durland* v. *United States,* 161 US 306, 313, 314 (1896); *United States* v. *Brandt,* 196 F. 2d 653, 657 (2d, 1952); *Troutman* v. *United States,* 100 F. 2d 628, 632 (10th, 1938); cert. den. 306 US 649[6]; *Rice* v. *United States,* 149 F. 2d 601, 603 (10th, 1945).[6]

The decision below does not conflict with any cases cited by SEC under other statutes[7]. These four cases involved a review of SEC orders revoking broker-dealer licenses. In each case unlisted securities were sold to customers at far in excess of the market price and in some instances the market was controlled by the defendants. Fraud and deceit were clearly established.

In *Securities and Exchange Commission* v. *Torr,* 87 F. 2d 446 (2d, 1937), the defendants were seeking to unload over 47,000 shares of stock and engaged a nationwide crew

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[4] *Hackner* v. *Morgan,* 130 F. 2d 300, 302 (2d, 1942); *United States* v. *Brown,* 79 F. 2d 321, 325 (2d, 1935).

[5] *United States* v. *Thompson,* 279 F. 2d 165, 167 (10th, 1960); *Equitable Life Insurance Co. of Iowa* v. *Halsey, Stuart & Co.,* 112 F. 2d 302, 308 (7th, 1940).

[6] These cases involved fraud provisions of the Securities Act of 1933, 15 USC 77q.

[7] *Charles Hughes & Co.* v. *Securities and Exchange Commission,* 139 F. 2d 434 (2d, 1943); cert. den. 321 US 786; *Norris & Hirshberg* v. *Securities and Exchange Commission,* 177 F. 2d 228 (CA, DC, 1949); *Archer* v. *Securities and Exchange Commission,* 133 F. 2d 795 (8th, 1943); cert. den. 319 US 767. In *Hughes* (Arleen) v. *Securities and Exchange Commission,* 174 F. 2d 969 (CA, DC, 1949) her investment adviser registration was not attacked but solely her broker-dealer registration. She was readmitted to registration as a broker-dealer, 30 SEC 390 (1949).

to recommend the stock so the defendants could unload. The fraud and deceit were apparent.

In *Ridgely* v. *Keene*, 134 App. Div. 647; 119 NYS 451 (2d Dept.) an adviser was engaged by stock brokers for compensation to recommend a stock in which the brokers had a pool and were seeking to raise the price and unload. There was palpable fraud.

In *Securities and Exchange Commission* v. *Frank Payson Todd*, Civil No. 6149 (D. Mass.), the defendant consented to an injunction which was vacated without objection of the SEC to permit a trial on the merits and the SEC eventually agreed to a dismissal as it appeared that the facts would not support an injunction[8].

Todd had been recommending to one group of clients to buy stock and, at the same time, selling out the stock in another group of clients' accounts.

The SEC, however, contends contrary to the decided cases that intent is immaterial[9].

The SEC further maintains that a breach of fiduciary duty is a violation of the statute, but, on the contrary, a violation requires fraud or deceit. A violation of a fiduciary duty may not be fraudulent.

There was not only no fraud or deceit but no breach of fiduciary duty.

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[8] *Loos Securities Regulation*, Vol. III, 2d ed., p. 1516.

[9] SEC brief, p. 11: "It is immaterial that respondents may have believed in the soundness of their recommendations or made them without conscious intent to advance their personal trading interests."

Similarly, brief, p. 18.

There was no proof of fraud or deceit.

The soundness of Capital Gains' recommendations is not questioned. Two courts have found that Capital Gains intended subscribers to have maximum profits. In fact, in the instances complained of, subscribers had the opportunity of long-term gain of from 34-84%.

The SEC contends that, regardless of Mr. Schwarzmann's honest reports and good intent, because Capital Gains, after completing its research and after deciding to recommend a stock, purchased a small amount of stock before issuing the bulletin and sold the stock from five to fourteen days thereafter without the bulletin containing a so-called broker-dealer disclosure footnote, such as "we may or may not hold the stocks recommended," a fraud and deceit has been perpetrated on subscribers.

The integrity of the recommendation is not altered because Capital Gains bought some shares after its decision to recommend but before the bulletin. Nor does the advice become disinterested because of the purchase. The recommendation would have been made regardless.

The suggestion that respondents' recommendation may have been motivated because of his small purchases and small profit is contrary to and a distortion of the facts. The advice was given in the course of business in the belief that subscribers would have long-term appreciation, which proved 100% correct. Capital Gains was contractually obligated to issue bulletins and the success of the business depended on the correctness of the advice.

Petitioner's indication (brief, p. 12) that respondents had a $90,000 a year business and made $20,000 in market profits is contrary to the facts. Capital Gains' gross from its publications was $570,000 a year (R. 25, 26, 27) and its

profits on the transactions were about half that claimed by the SEC, or about $10,000 (R. 28-32).

It defies common sense to believe a man who spent seven years to build up a business with a gross of over half a million dollars a year would endanger that business for an extra profit of $10,000 if he had any reason to believe that he was doing something wrong. It is more incredible to believe he was issuing bulletins so he could make small market profits instead of developing the further growth of the business.

The SEC (brief, p. 9) misquotes the opinion below by omitting "tends". The opinion said "the SEC's proof *tends* only to show that, at most * * * Schwarzmann profited personally from the predictable market effect of his honest advice" (R. 65). (Emphasis supplied.)

There was no proof but surmise that the bulletins moved stock issues with millions of shares, one with 77,000,000 (*supra* p. 6). Other advisory services and brokers recommended some of the issues (R. 30, 31, 32) and there are thousands of brokers who could have been recommending them at the same time. Nor was there any proof that any subscriber did in fact purchase. In one instance subscribers were told not to be in haste to buy so as not to disturb the market (R. 32, 41). Nor were the profits "predictable", as witness the loss of $6,962.50 on the Chock Full options, which were completely worthless (R. 29).

An investment adviser has the right to use his own work product to buy and sell in the open market, barring some regulation to the contrary. No regulation as to trading or the manner or extent of disclosure was ever promulgated, although the SEC had general rule-making power under the Act since 1940 (§ 80b-11) and was directed to make rules under the 1960 amendment (§ 80b-6(4)). Common sense

would dictate that a subscriber would expect an adviser to do so. The statute (§80b-6(3)) contemplates that an adviser would trade and contains the only provision for disclosure, i.e., when an adviser sells directly to a subscriber.

The adviser's purchases were not contrary to his recommendation to purchase for long-term gain. If he purchased none, on petitioner's theory, an adviser might be guilty of deceit by not disclosing that he did not follow his own advice.

The point of departure here is that although the adviser purchased he did not hold for a long-term gain. There is neither legal nor moral obligation that an adviser buy every stock he recommends and hold it for as long as he recommends at the peril of being accused of fraud.

It has been conceded that it would not be fraud for an adviser to buy and hold for a long-term gain as recommended, i.e., for six months, without disclosure.

Does it turn fraudulent if the adviser buys but holds for five months and 29 days instead of six months? Or if he holds only for four months, two months, one month, or ten days? Obviously not! The crucial test is, was the advice honest and given in good faith with honest intent that subscribers have the opportunity for long-term gain.

The respondents' transactions were not a material fact as to whether the advice was honest and with good intent or that subscribers could have an opportunity for long-term profit therefrom.

The accepted form of disclosure of broker-dealers for over twenty years, that they "may from time to time hold a position in the securities mentioned", cannot be the difference between integrity and fraud. This uninformative phrase which the SEC considers sanctifying for broker-dealers, is worship of "disclosure" as a shibboleth—of form to substance.

No disclosure can make a dishonest transaction honest, nor lack of disclosure make an honest one dishonest.[10]

The non-disclosure, to constitute fraud, must not only be as to a material fact but it must be with intent to deceive.[11]

The inclusion of the standard broker-dealer "disclosure clause" in a bulletin would give the subscribers no more information as to whether the recommendation for long-term profit was sound and with honest intent than if omitted. The omission constituted no deceit and surely was with no intent to deceive.

There is no element of manipulation involved. There was no proof that respondents' transactions interfered with or were adverse to subscribers' opportunity for long-term gain. There was no proof that the reports in fact influenced the market,[12] but, assuming they had, a correct report issued in the course of business that a stock is undervalued, even if it causes the market to rise, is not manipulative. "Manipulation" means to artificially raise prices.[13] In any event, the manipulation would have to be one that deceived or defrauded the subscriber, which is patently not the case.

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[10] *Epstein v. United States*, 174 F. 2d 754, 768 (6th, 1949).

[11] *Otis & Co. v. Securities and Exchange Commission*, 106 F. 2d 579, 582 (6th, 1939).

[12] The SEC brief (footnote 5, p. 15) now tries to supply inferential proof, not part of the record nor competent evidence, and not dealing with the facts.

[13] Securities Exchange Act, 15 USC 78i, j, and rules thereunder.

There Was No Breach of Fiduciary Duty.

The SEC contends that a breach of fiduciary duty is a violation of the statute.

> "* * * But to say that a man is a fiduciary only begins analysis; * * * What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?" *Securities and Exchange Commission* v. *Chenery Corp.*, 318 US 80, 85, 86 (1943).

The obligations respondents owed to subscribers was to give honest advice with honest intent that subscribers would have the opportunity for long-term capital appreciation. This obligation was fulfilled 100% and was in no wise impaired by the adviser making a profit on his own research in a manner which in no way interfered with the subscriber's possibilities for long-term appreciation. The adviser's transactions were his private affair and did not alter the integrity of his advice or his good intent; nor did the omission of a so-called broker-dealer "disclosure clause".

But breach of duty is not a violation of the statute—the test is fraud or deceit.

> " * * * Whether a breach of trust is an active fraud depends upon what the particular breach of trust consists of * * *." *Epstein, supra*, p. 766.

United States v. *Buckner*, 108 F. 2d 921, 926 (2d 1940), cited by the SEC, is not contrary; there was "an active fraud".

There was no breach of fiduciary duty and the finding in three decisions below of no fraud and deceit upon which to predicate a preliminary injunction was clearly sup-

ported by the record and is held unassailable under the rule of this Court[14].

There Was No Abuse of Discretion in Denying the Preliminary Injunction.

In reviewing the denial of a preliminary injunction, the question is whether the denial was an abuse of discretion. Discretion is implicit in the decision even if not expressed.[15] The ultimate merits are not at issue.[16]

Not only was there failure of proof but the suit and preliminary injunction were unnecessary.

Prior to the commencement of the suit in November, 1960, when the transactions were questioned, respondents, while asserting no fraud or deceit had been perpetrated, were willing to abide by any suggested practice as to trading or not trading or a disclosure thereof that the SEC deemed advisable (R. 22, 26, 32).

Instead of handling the situation as an administrative matter (the Commission has the right to revoke an adviser's registration (15 USC 80b-3(d)), since the practice complained of had ceased, the Commission, nevertheless, on a two-day investigation, embarked upon this litigation.

An injunction is not justified by the fact that a defendant is in a position to commit a violation or that plaintiff thinks he might.[17]

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[14] *Comstock* v. *Group of Institutional Investors,* 335 US 211, 214 (1948); *Alabama Power Co.* v. *Ickes,* 302 US 464, 477 (1938).

[15] *United States* v. *Corrick,* 298 US 435, 437, 438 (1936).

[16] *Alabama* v. *United States,* 279 US 229, 231 (1929); *Meccano, Ltd.* v. *John Wanamaker,* 253 US 136, 141, 142 (1920).

[17] *United States* v. *U. S. Steel Corp.,* 251 US 417, 445 (1920); *Securities and Exchange Commission* v. *Torr,* 87 F. 2d 446 (2d, 1937).

Nor should a preliminary injunction be granted where its effect is to give final relief before a trial of the issues.[18]

The litigation is nigh three years old and the Commission is still seeking a preliminary injunction, making no effort to proceed on the merits. Petitioner does not deny that the acts complained of ceased three years ago.

The purpose of injunctive relief is not to punish for past acts, assuming they were unlawful, but in a proper case to prevent future violations.[19] When the acts complained of have ceased there is no reason for the suit or for injunction, no triable issue, and the case is moot.[20]

This Court does not review the right to a preliminary injunction where the necessity for relief does not exist[21]

Petitioner Has Unlawfully Used Publicity to Destroy Respondents' Business and Reputation.

The traditional rules of equity apply to actions involving Governmental agencies.[22] A seeker of equity must do equity.

The day after this action was commenced in November, 1960, not content with publicizing information contained in the moving papers, there appeared in the public press:

> "According to Henry B. Bright of New York, senior attorney for the SEC, who brought the complaint against Schwarzmann, 'this is the biggest

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[18] *Securities and Exchange Commission* v. *Torr, supra; United States* v. *Adler's Creamery,* 107 F. 2d 987, 990 (2d, 1939); cert. den. 311 US 657.

[19] *Hecht Co.* v. *Bowles,* 321 US 321, 329 (1944); *Walling* v. *T. Buettner & Co.,* 133 F. 2d 306 (7th, 1943).

[20] *Walling* v. *Shenandoah-Dives Mining Co.,* 134 F. 2d 395 (10th, 1943).

[21] *United States* v. *Alaska S.S. Co.,* 253 US 113, 116 (1920).

[22] *Alabama* v. *United States, supra,* p. 230.

> fraud of its kind which we have discovered on the market in the last 10 years.' " (R. 25.)

This was before respondents had an opportunity to file an answering affidavit, which has never been contradicted.

Such publicity is forbidden by the Investment Advisers Act (80b-10(b)) which provides the Commission or employee "shall not make public * * * the results of or any facts ascertained during any such * * * investigation".[28]

Despite these clearly defined restrictions on publicity, designed and spelled out to protect innocent people, to prevent the destroying of reputation and creating prejudice to a fair hearing, other statements not appearing in the moving papers appeared in the public press emanating from petitioner's office (R. 25). Such publicity is in violation of Canon 20 of the American Bar Association Canons of Professional Ethics, proscribing trying cases in the newspaper to the prejudice of respondent's rights and the administration of justice.

The 1960 Amendment Was to Enable the SEC to Deal with "Material Adverse Interests" of Investment Advisers.

In 1960 the Investment Advisers Act was amended by adding to Section 206 Subdivision (4). This amendment was sought by the SEC for the purpose of enabling it to deal with "such problems as a *material* adverse interest in securities which the adviser is recommending to his clients" (R. 69, 70).

To obtain the amendment, SEC representatives testified before a Congressional subcommittee that an investment

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[28] The restriction on publicity may explain the resort to court action instead of the use of completely adequate administrative procedures provided by the Act (§80b-3(d)).

adviser who recommended an issue of debentures of an affiliate was not required to disclose its financial interest (R. 68, 69).

In sharp contrast they now argue (brief, p. 10) that an adviser must render "completely disinterested advice" and yet concede that there are situations "where there may be no need of disclosure of the adviser's interest" (brief, p. 13).

Here the adviser's purchases were not adverse to, nor did they in any way interfere with, the subscribers' opportunity for long-term gain.

The SEC has had general rule-making power for over twenty years, and sought the 1960 amendment of the statute to obtain specific rule-making power to deal with problems of "material adverse interests," and yet has made no rules dealing with this problem which might serve as a guide to the industry. It would seem that justice and fair play would require that they do this and that they handle situations such as this present case in administrative proceedings before they embark in litigation accusing someone of fraud and deceit.

Conclusion.

The judgment of the Court of Appeals should be affirmed or the writ dismissed.

Respectfully submitted,

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